

## Internal Revenue Service

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Person To Contact:

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Telephone Number:

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CC:PSI:B01 – PLR-129449-08

Date:

December 19, 2008

X =

Date 1 =

Date 2 =

Date 3 =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

PLR-129449-08

Trust 8 =Trust 9 =Trust 10 =

Dear :

This responds to a letter dated June 4, 2008, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

#### Facts

The information submitted states that X elected to be an S corporation effective Date 1. On Date 1, Trust 1 was a shareholder of X. However, the trustee of Trust 1 failed to make an ESBT election. Therefore, Trust 1 was an ineligible shareholder and X's election to be an S corporation was invalid. Additionally, Trust 2 became a shareholder of X on Date 2. The trustee of Trust 2 failed to make an ESBT election effective Date 2. Therefore Trust 2 was an ineligible shareholder, effective Date 2.

X represents that there was no intent to terminate X's S corporation election and that the failure to file timely the ESBT elections for Trust 1 and Trust 2 was not motivated by tax avoidance or retroactive tax planning. X represents that Trust 1 and Trust 2 each comply with the requirements under § 1361(e), which defines an ESBT.

Further, effective Date 1, in conjunction with X's S corporation election, Trust 1, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, and Trust 10 (the "Electing Trusts") made elections to be treated as Qualified Subchapter S Trusts (QSSTs). However, X represents that the Electing Trusts did not intend to become QSSTs and that none of the current income beneficiaries of any of the Electing Trusts signed the QSST election as required under § 1.1361-1(j)(6)(ii). Moreover, the Electing Trusts, with the exception of Trust 1, had already made ESBT elections prior to the time they became shareholders of X.

X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(h)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted shareholder, but only for the two-year period beginning on the day of the deemed owner's death. Section 1.1361-1(h)(3)(i)(B) provides that if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if --

(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of § 170(c), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,

(ii) no interest in such trust was acquired by purchase, and

(iii) an election under this subsection applies to such trust.

Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1361(d)(3)(A) provides that a QSST is a trust, the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary. In addition, § 1361(d)(3)(B) requires that the trust distribute (or require to be distributed) all of its income (within the meaning of § 643(b)) currently to 1 individual who is a citizen or resident of the United States.

Section 1361(d)(1) provides that, in the case of a QSST with respect to which a beneficiary makes an election under § 1361(c)(2), (A) such trust will be treated as a trust described in § 1361(c)(2)(A)(i), and (B) for purposes of § 678(a) the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361 (b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

### Conclusion

Based solely on the information submitted, and the representations made, we conclude that X's S corporation election was an inadvertent invalid election within the meaning of section 1362(f). In addition, X's S corporation election would have terminated when Trust 2 became a shareholder of X. We also conclude that this termination would have constituted an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as an S corporation effective Date 1 and thereafter provided that X's election to be an S corporation was not otherwise invalid and not terminated under section 1362(d). Trust 1 will be treated as an ESBT under section 1361(e) effective Date 3 and as a shareholder of X effective Date 1. Trust 2 will be treated as an ESBT under section 1361(e) and as a shareholder of X effective Date 2.

These rulings are conditioned upon Trust 1 and Trust 2 filing ESBT elections effective Date 3 and Date 2, respectively, with the appropriate Service Center within 60 days of the date of this letter. A copy of this letter should be attached to the ESBT elections. If X or X's shareholders fail to treat X as described above, this ruling will be null and void.

In addition, we further conclude that the QSST elections made by the Electing Trusts, effective Date 1, as part of X's S corporation election, were invalid and did not result in any of the Electing Trusts making a QSST election or being converted from ESBTs to QSSTs.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on: (1) Whether X is otherwise eligible to be treated as an S corporation; and (2) Whether Trust 2 or the Electing Trusts are eligible ESBTs under section 1361(e).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,  
*David R. Haglund*

David R. Haglund  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes

cc: